

Message Text

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ACTION TRSE-00

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P R 200530Z SEP 76

FM AMEMBASSY SEOUL

TO SECSTATE WASHDC PRIORITY 9558

INFO AMCONSUL HONG KONG

LIMITED OFFICIAL USE SECTION 1 OF 2 SEOUL 7492

EO 11652: N/A

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SUBJECT: BALANCE OF PAYMENTS AND DEBT PROSPECTS

HONG KONG FOR REGIONAL FINANCIAL ATTACHE

REF: STATE 223505

SUMMARY: IN RESPONSE TO REFTEL'S REQUEST FOR INFORMATION ON KOREA'S BALANCE OF PAYMENTS AND DEBT PROSPECTS, WE CURRENTLY FORESEE A CURRENT ACCOUNT DEFICIT OF \$550 MILLION IN 1976 AND, ON THE BASIS OF CURRENT TRENDS AND ASSUMING NO MAJOR SHIFTS IN POLICY, A DEFICIT OF ABOUT \$500 MILLION IN 1977. GIVEN THE REMARKABLE IMPROVEMENT IN KOREA'S BALANCE OF PAYMENTS AND DEBT SITUATION THAT IS OCCURING IN 1976, KOREA'S DEBT OUTLOOK IS EXCELLENT. END SUMMARY

1. DATA AND ESTIMATES ON KOREAN BALANCE OF PAYMENTS AND DEBT PROSPECTS AS REQUESTED REFTEL ARE AS FOLLOWS:

2. BALANCE OF PAYMENTS (\$ BILLIONS)

1974 1975 1976 1977

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CURRENT ACCOUNT -2.0 -1.9 -0.55 -1.5

A. MERCH. EXPORTS 4.5 5.0 7.7 10.0

B. MERCH. IMPORTS 6.4 6.7 8.1 10.3

C. SERVICE EXPORTS .8 .9 1.35 1.6

D. SERVICE IMPORTS 1.1 1.3 1.70 2.0

E. NET TRANSFERS .2 .2 .2 .2

CAPITAL ACCOUNT

F. NET OFFICIAL LONG

TERM 0.4 0.7 0.7 0.9

G. NET OFFICIAL SHORT

TERM 0.0 0.0 0.0 0.0

H. NET PRIVATE LONG

TERM 0.7 0.8 0.7 0.7

I. NET PRIVATE SHORT TERM

AND OTHERS 0.9 1.1 0.3 -0.3

J. CHANGE IN FX RESERVE 0.0 -0.5 -1.15 -0.8

(MINUS INDICATES INCREASE)

K. GROSS FX LEVEL 1.05 1.55 2.7 3.5

3. EXTERNAL DEBT DATA (ONE YEAR AND OVER) (\$BILLIONS)

1974 1975 1976 1977

DISBURSED 4.3 5.8 7.2 8.6

(PUBLIC) (1.9) (2.5) (3.3) (4.2)

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(PRIVATE) (2.4) (3.3) (3.9) (4.4)

UNDISBURSED 2.2 2.0 2.3 2.8

(PUBLIC) (0.9) (1.2) (1.3) (1.5)

DEBT SERVICE 0.66 0.75 1.02 1.39

4. THE ROKG, AS A GENERAL PRACTICE, DOES NOT RELEASE DATA ON OUTSTANDING SHORT-TERM DEBT. ON THE BASIS OF OCASIONAL GLIMPSES WE HAVE HAD AT PRATIAL FIGURES, NET YEAR-TO-YEAR CHANGES WHICH ARE REPORTED AND COMMENTS OF ROKG OFFICIALS, WE ESTIMATE SHORT-TERM DEBT OUTSTANDING IN THE FORM OF PROVATE TRADE CREDITS AND BANK REFINANCING AS ROUGHLY \$2.3 BILLION WHICH WE PROJECT TO DECLINE TO ABOUT \$2.0 BILLIN BY END 1977. WORK-ING BACK FROM THIS ESTIMATE A ROUGH CONSTRUCTION OF SHORT-TERM DEBT OUTSTANDING, LIMITED TO PRIVATE TRADE CREDITS AND BANK REFINANCING, WOULD BE:

(\$ BILLIONS)

1973	1974	1975	1976	1977
0.6	1.2	2.0	2.3	2.0

NOTE: SOME OF THE NET SHORT-TERM AND OTHER CAPITAL INFLOWS INDICATED IN THE BALANCE OF PAYMENTS TABLES ABOVE INCLUDE NET DECREASES IN CERTAIN DEPOSITS IN BANK INTEROFFICE ACCOUNTS NOT INCLUDED IN GROSS FX RESERVES AND INCREASES IN SUCH LIABILITIES AS DEPOSITS OF FOREIGNERS, CURRENCY SWAPS WITH RESIDENT FOREIGN BANK BRANCHES, ETC.

5. AS CONCERNS DEFINITIONS, WE ASSUME THE TERM "OFFICIAL CAPITAL" CORRESPONDS TO THE TERM "PUBLIC LOANS" USED IN KOREA, MEANING CAPITAL FLOWS WHICH INVOLVE A GOVERNMENT OR GOVERNMENT AGENCY OR AN INTERNATIONAL FINANCIAL INSTITUTION OR AGENCY AS EITHER THE BORROWER OR LENDER OR BOTH. LOANS TO THE PRIVATE LIMITED OFFICIAL USE

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SECTOR WHICH ARE DIRECTLY OR INDIRECTLY GUARANTEED BY THE ROKG ARE TREATED AS PRIVATE CAPITAL FLOWS. ALL BUT A SMALL PORTION OF KOREA'S PRIVATE SECTOR EXTERNAL LONG AND MEDIUM TERM DEBT IS GUARANTEED DIRECTLY OR INDIRECTLY BY THE ROKG. WE ALSO DISTRIBUTED NET INFLOWS RECORDED IN THE MONETARY ACCOUNT, E. G., IMF CREDITS, BANK REFINANCING, BETWEEN LONG AND SHORT TERM, PUBLIC AND PRIVATE CAPITAL INFLOWS AS APPROPRIATE.

6. SOURCES: 1974 AND 1975 DATA ARE OFFICIAL FINAL FIGURES OF THE BANK OF KOREA (BOK) FOR BALANCE OF PAYMENTS AND OF THE ECONOMIC PLANNING BOARD (EPB) FOR EXTERNAL DEBT AND ARE CONSIDERED VERY RELIABLE. ESTIMATES FOR 1976 AND 1977 ARE OUR ESTIMATES AS DISCUSSED BELOW.

7. THE CURRENT ACCOUNT FORECAST FOR 1976 IS BASED ON PARTIAL DATA, INCLUDING SUCH LEADING INDICATORS AS EXPORT L/C ARRIVALS AND IMPORT LICENSING, THROUGH AUGUST AND PRELIMINARY BOK DATA ON FIRST HALF RESULTS JUST OBTAINED (WHICH SHOW A FIRST HALF CURRENT ACCOUNT DEFICIT OF \$293 MILLION - A REPORT ON THESE DATA WILL FOLLOW SHORTLY). THIS FORECAST COUNTINUES TO BE MORE OPTIMISTIC THAN QUASI-OFFICIAL FORECASTS OF ROKG AGENCIES ALTHOUGH THE DIFFERENCE IS NARROWING. THE LATEST MINISTRY OF FINANCE (MOF) FORECAST FORESEES A CURRENT ACCOUNT DEFICIT OF \$734 MILLION WITH THE DIFFERENCE CHIEFLY ACCOUNTED FOR BY THEIR ESTIMATE OF \$7.6 BILLION INSTEAD OF \$7.7 BILLION FOR EXPORTS AND THEIR ESTIMATE OF A DEFICIT OF \$275 MILLION RATHER THAN \$150 MILLION FOR NET SERVICES AND TRANSFERS. MOF OFFICIALS DESCRIBED THEIR FORECAST AS CONSERVATIVE AND THEY BELIEVE A SMALLER DEFICIT IS LIKELY. EPB'S CURRENT FORECAST IS SIMILAR TO MOF'S WITH THE EXCEPTION THAT IT ASSUMES EXPORTS OF ONLY \$7.350 BILLION PRODUCING A CURRENT ACCOUNT DEFICIT OF ROUGHLY \$1 BILLION. FOR OUR PART, WE BELIEVE, IN ANYTHING, EXPORTS WILL EXCEED \$7.7 BILLION BY \$100 TO \$200 MILLION AND THAT IT IS ENTIRELY POSSIBLE THAT THE CURRENT ACCOUNT DEFICIT WILL BE EVEN SMALLER THAN OUR CURRENT FORECAST OF \$550 MILLION.

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TO SECSTATE WASHDC PRIORITY 9559
INFO AMCONSUL HONG KONG

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8. OUR ESTIMATES FOR THE 1976 CAPITAL ACCOUNT ARE SLIGHTLY MODIFIED VERSIONS OF CURRENT MOF AND EPB ESTIMATES, DIFFERING PRINCIPALLY IN THAT WE EXPECT SOMEWHAT LOWER PUBLIC LOAN ARRIVALS AND SOMEWHAT HIGHER NET SHORT-TERM INFLOWS. PROJECTED CHANGES IN FX RESERVES VARY ROUGHLY BY DIFFERENCES IN CURRENT ACCOUNT FORECASTS WITH EPB PROJECTING \$2.3 BILLION, MOF \$2.5 BILLION AND EMBASSY \$2.7 BILLION. RESERVES AS OF AUGUST 31 WERE \$2.3 BILLION.

9. OUR FORECAST FOR 1977 IS BASICALLY A MODIFIED VERSION OF CURRENT WORKING ESTIMATES DEVELOPED BY EPB AND THE KOREA DEVELOPMENT INSTITUTE (KDI), AN ECONOMIC THINK TANK CLOSELY ALLIED WITH EPB. IN A RECENT FORECASTING EXERCISE, KDI PROJECTED 1977 EXPORT GROWTH OF 29 PERCENT TO 33 PERCENT, INCLUDING PRICE INCREASES OF 5 PERCENT, AND IMPORT GROWTH OF 26 PERCENT TO 29 PERCENT, INCLUDING PRICE INCREASES OF 8 PERCENT. THE RATIONALE FOR ASSUMING SOMEWHAT HIGHER INFLATION FOR IMPORT PRICES THAN EXPORT PRICES WAS APPARENTLY BASED ON THE ASSUMPTION THAT RAW MATERIAL PRICES ARE LIKELY TO RISE FASTER THAN PRICES OF MANUFACTURED PRODUCTS IN 1977. IT ALSO ALLOWS FOR SOME ADJUSTMENT OF THE 1976 TREND WHEN KOREA'S EXPORT PRICES ARE EXPECTED TO RISE ABOUT 12 PERCENT AS COMPARED TO ONLY A 4 PERCENT RISE FOR IMPORT PRICES. THIS EXERCISE ALSO ASSUMED 1977 REAL GROWTH RATES OF 10 PERCENT FOR LIMITED OFFICIAL USE

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KOREA, AND 4.5 PERCENT AND 7.5 PERCENT RESPECTIVELY FOR THE U.S. AND JAPAN, KOREA'S MAJOR TRADING PARTNERS. DRAWING ON THESE PROJECTIONS, OUR FORECAST ASSUMES AN INCREASE IN EXPORTS OF 30 PERCENT AND INCREASE IN IMPORTS OF 27 PERCENT. IT SHOULD BE NOTED THAT KDI-EPB ARE CURRENTLY USING A BASE OF \$7,350 MILLION FOR EXPORTS AND \$8,100 FOR IMPORTS IN 1976 SO THAT THEY GET A TRADE DEFICIT ON THE ORDER OF \$800 MILLION FOR 1977 RATHER THAN OUR \$300 MILLION FORECAST.

10. WHILE THE EXPORT FORECAST IS SENSITIVE TO DIFFERING RATES OF GROWTH IN OECD COUNTRIES, PRODUCTION CAPACITY LIMITATIONS AND TRADE BARRIERS SUCH AS TEXTILE QUOTAS ARE LIKELY TO BE AS MUCH OF A CONSTRAINING FACTOR AS THE LEVEL OF DEMAND IN OECD COUNTRIES, ASSUMING A REASONABLY STRONG RECOVERY IN OECD COUNTRIES CONTINUES THROUGHOUT 1977.

11. WE BELIEVE OUR IMPORT FORECAST FOR 1977 CAN ONLY BE JUSTIFIED BY ASSUMING STRONG INFLOWS OF CAPITAL EQUIPMENT AND A GENERAL EASING OF IMPORT RESTRAINTS. ROKG ACTIONS TO EASE UP ON IMPORT RESTRAINTS HAVE BEEN DECIDEDLY TIMID TO DATE, BUT THERE HAVE BEEN SOME INDICATIONS IN RECENT WEEKS THAT STRONGER ACTIONS ARE AT LEAST BEING CONSIDERED. WE AND THE IMF HAVE BEEN URGING SUCH A COURSE AT EVERY OPPORTUNITY. AN 8 PERCENT INCREASE IN CRUDE OIL PRICES WOULD NOT ALTER THE IMPORT FORECAST SINCE IT ASSUMES 8 PERCENT INFLATION. IT COULD HAVE AN IMPACT ON THE EXPORT PROJECTION IF IT RESULTS IN REDUCED NON-CRUDE OIL IMPORTS BY THE INDUSTRIALIZED NATIONS.

12. ONE OTHER QUESTION MARK ABOUT IMPORTS CONCERNS DEFENSE IMPORTS. THE ABOVE FORECASTS HAVE NOT USED AN OBJECTIVE FORECAST OF DEFENSE IMPORTS, BUT THERE IS SOME ROOM IN BOTH THE 1976 AND 1977 FIGURES TO ACCOMMODATE THEM. ON BALANCE, IT IS POSSIBLE THAT OVERALL 1976 AND 1977 IMPORT TOTALS COULD BE \$200 TO \$300 MILLION DOLLARS HIGHER IF ALL NON-GRANT DEFENSE IMPORTS ARE INCLUDED. THIS WOULD ROUGHLY CORRESPOND TO ANTICIPATED INFLOWS OF FMS CREDITS ON THE CAPITAL SIDE WHICH WOULD THEN ALSO BE ADJUSTED UPWARD SINCE THEY ARE NOT INCLUDED IN THE ABOVE FIGURES. IN OTHER WORDS, THE ABOVE ESTIMATES PROBABLY HAVE ENOUGH LEEWAY TO COVER AT LEAST THOSE DEFENSE IMPORTS FINANCED FROM KOREAN FOREIGN EXCHANGE.

13. THE ABOVE 1976 AND 1977 ESTIMATES FOR EXTERNAL DEBT CORRESPOND LIMITED OFFICIAL USE

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QUITE CLOSELY TO CURRENT EPB FORECASTS AFTER ADJUSTING FOR THE LOWER PUBLIC LOAN ARRIVAL FIGURE WE ANTICIPATE IN 1976.

14. OUR FORECAST FOR 1977 IS ESSENTIALLY AN OUTLINE OF WHERE WE BELIEVE THE KOREAN BALANCE OF PAYMENTS AND DEBT SITUATION IS HEADED BASED ON CURRENT TRENDS AND ASSUMING NO MAJOR SHIFTS IN ROKG POLICY. A SHIFT IN ROKG POLICY COULD EASILY ALTER THIS OUTCOME. THEY COULD STEP UP IMPORTS TO PURSUE A HIGHER GROWTH RATE OR CUT BACK ON FOREIGN BORROWING EITHER BY MOVING SLOWER ON LONGER TERM BORROWING OR RETIRING MORE SHORT TERM DEBT. FOR THE MOMENT, IN OUR OPINION, THEY ARE THE VICTIMS OF THEIR OWN CAUTIOUS FORECASTING, WITH EPB STILL THINKING IN TERMS OF A CURRENT ACCOUNT DEFICIT OF \$1 BILLION IN 1976. IF FURTHER EXPERIENCE SHOWS THAT OUR PROJECTION OF THE 1976 OUTCOME IS ACCURATE, WE ANTICIPATE THAT THE ROKG WILL BEGIN TO SHIFT COURSE BY ADOPTING SOME MIX OF THE MEASURES SUGGESTED ABOVE. WE CAN FORESEE, FOR EXAMPLE, A COMBINATION OF INCREASED IMPORTS AND FASTER RETIREMENT OF SHORT TERM DEBT THAT MIGHT HOLD NEXT YEAR'S FX RESERVE LEVEL TO ABOUT \$3 BILLION.

15. AS CONCERNS THE DEBT OUTLOOK OVER THE NEXT FOUR YEARS, THE SPECTACULAR PERFORMANCE IN 1976 HAS LARGELY OFFSET, IN A SINGLE YEAR, THE ADVERSE EFFECTS OF THE OIL CRISIS AND INTERNATIONAL-

AL RECESSION ON KOREA'S DEBT AND BALANCE OF PAYMENTS POSITION. WHILE KOREA HAS INCURRED SUBSTANTIAL ADDITIONAL EXTERNAL DEBT, ITS DEBT SERVICE RATIO TO DEBT OF ONE YEAR AND OVER HAS ACTUALLY DECLINED FROM 13.9 PERCENT IN 1973 TO AN ESTIMATED 11.2 PERCENT IN 1976. NET FOREIGN ASSETS, WHICH HAD DROPPED TO A NEGATIVE \$691 MILLION BY APRIL 1975, SHOULD BE A POSITIVE \$500 MILLION OR HIGHER BY DECEMBER 31, 1976. THE LARGE INCREASE IN SHORT-TERM DEBT LOOKS FAR LESS IMPOSING NOW IN TERMS OF ITS RELATIONSHIP TO TOTAL TRADE AND THE LEVEL OF FX RESERVES. THE SECURITY SITUATION REMAINS A MAJOR VARIABLE. A SERIOUS DETERIORATION IN THE SECURITY SITUATION, NOT FORESEEN AT THIS TIME, BUT ALWAYS AN OUTSIDE POSSIBILITY, COULD ALTER KOREA'S ECONOMIC OUTLOOK OVERNIGHT. EVEN AS IT STANDS NOW, THE SECURITY SITUATION IS A MAJOR BARRIER TO OBTAINING LONGER TERM FINANCING FROM COMMERCIAL SOURCES WITHOUT APPROPRIATE FOREIGN GOVERNMENT GUARANTEES, A PROBLEM THAT WOULD BE COMPOUNDED BY A PREMATURE PHASING OUT OF LENDING FROM OFFICIAL SOURCES. WITH THOSE QUALIFICATIONS, HOWEVER, WE WOULD ASSESS KOREA'S DEBT OUTLOOK OVER THE NEXT FOUR YEARS AS EXCELLENT.

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Message Attributes

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